

Item

CAMBRIDGE CITY HOUSING COMPANY LIMITED - REVIEW OF PILOT PHASE

To:

Councillor Lewis Herbert, Leader and Executive Councillor for Strategy and External Partnerships

Strategy & Resources Scrutiny Committee 08/02/2019

Report by:

Caroline Ryba, Head of Finance and S151 officer

Tel: 01223 - 458134 Email: caroline.ryba@cambridge.gov.uk

Wards affected:

All

The appendix to the report contains exempt information during which the public is likely to be excluded from the meeting subject to determination by the Scrutiny Committee following consideration of a public interest test. This exclusion would be made under paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

Key Decision

1. Executive Summary

- 1.1 This report presents the review of the pilot phase of the Cambridge City Housing Company Limited (CCHC) and considers whether the pilot phase should be continued, the company should be moved into business as usual, or it should be closed. The risks and potential impacts for the council, as the only shareholder in the company, are reviewed.

2. Recommendations

The Executive Councillor is recommended to:

- 2.1 Approve that CCHC moves from its pilot phase into business as usual.
- 2.2 Confirm the Council's financial support for the company, subject to ongoing review by the S151 officer.
- 2.3 Agree that the Council refinance the existing loan to the company for three years at 2.02%.
- 2.4 Support the company directors' recommendation that, in view of the possible market impact of Brexit, any decision on further investment is delayed until at least the final quarter of 2019/20, or until the local property market has stabilised.
- 2.5 Agree that a third director is appointed to the company.

3. Background

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- 3.1. CCHC was set up as a three-year pilot. The company board comprises the Head of Commercial Services and the Head of Finance acting as Directors and the Head of Property Services as the Company Secretary. The board has undertaken a review of the current performance of the pilot, as recommended when the company was set up. This review is attached at Appendix 1.
- 3.2 The review concludes that CCHC has broadly achieved its objectives of providing housing at intermediate rents and a return to the council. There were start-up issues relating to delayed handover of the properties, setting rents at an achievable level and snagging problems. However, once these issues had been overcome, void levels have been very low and rental income has covered management and interest costs. The review recommends that the pilot phase is concluded and that CCHC moves to business as usual operation.
- 3.3 The review also considered possible future developments for the company and reviewed its business plan. In particular it considered a number of critical financial estimates and assumptions. It is this work that has highlighted significant risks in the company, and hence for the council.
- 3.4 The risks to the council are set out in Section 4 below. Appendix 1 lists risks to the company in paragraph 1.6. In particular it notes that the directors of CCHC are personally liable for the actions of the company and at risk of disqualification from acting as a director for up to 15 years if, for example, they allow a company to continue trading when it cannot

pay its debts. The directors are reliant on the council continuing to provide financial support to the company.

3.5 There are two further key decisions for the council to make:-

- As shareholder: should the company extend, maintain or liquidate its property holdings?
- As funder: at what terms (rate, duration) should the council refinance the current property portfolio, and if further properties are to be purchased, what terms should be offered to the company for any additional loans?

4.0 Risks to the Council

4.1 The council's objectives in setting up CCHC were to:-

- Acquire properties to let on short-term tenancies at 80% of market rent to meet the needs of those who do not have priority for social housing but cannot afford market rents; and
- To generate revenue to protect services.

In summary the risks to these objectives, described in accordance with the Council's risk management strategy, are set out below. Adding to the company's portfolio will not change the risks, but is likely to increase the probability of risks crystallising and the impact if they do.

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| <p>Risk 1 CCHC is unable to meet interest payments on the loans when they become due. (Category = Financial)</p> | |
| <p>Likelihood = Low Impact = High</p> | |
| <p>Cause</p> <ul style="list-style-type: none"> • Rent levels cannot be increased as expected • Void levels increase • Other expenses such as maintenance and administration increase more than expected • Interest rate increases | <p>Consequence</p> <ul style="list-style-type: none"> • CCHC will become cash flow insolvent and will require support from the council to trade out of this situation • If it is not possible to turn the company around, the properties will have to be sold and the company closed down. Market falls, disposal costs and the quantity of properties may give rise to capital losses |

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| | <ul style="list-style-type: none"> The value of the loans on the council's books will be impaired, with a charge to the General Fund (in accordance with International Financial Reporting Standard (IFRS) 9). Service budgets will be reduced, or reserves used to balance the council's budget |
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| <p>Risk 2 Interest payments do not provide additional revenue (above that on a typical cash deposit). (Category = Financial, Political)</p> | |
| <p>Likelihood = Medium Impact = Low</p> | |
| <p>Cause</p> <ul style="list-style-type: none"> Returns on cash deposits rise so that they are equal or above the interest rate on the loan to CCHC The interest rate on the loan is fixed for a lengthy period at a level that does not reflect the duration of the loan so cannot be flexed to reflect market rates The loan is refinanced at a rate that does not provide additional revenue | <p>Consequence</p> <ul style="list-style-type: none"> Additional revenue is not achieved Higher interest receipts are foregone Additional service spending is not supported State aid risk (see risk 4) is increased |

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| <p>Risk 3 Property values fall below the total amount of the loans. (Category = Financial)</p> | |
| <p>Likelihood = Medium Impact = High</p> | |
| <p>Cause</p> <ul style="list-style-type: none"> Property market decline or crash, possibly as a result of Brexit | <p>Consequence</p> <ul style="list-style-type: none"> CCHC will be balance sheet insolvent (liabilities will exceed assets) and will require support |

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| <ul style="list-style-type: none"> • Properties are not well maintained • Type of properties held are not seen as desirable | <p>from the council to trade out of this situation</p> <ul style="list-style-type: none"> • The council will only be able to exit from the company by crystallising the capital loss • Minimum revenue provision (MRP) will have to be charged on the internal borrowing that supports the loan (£188k p.a. on current portfolio) • The value of the loans on the council's books will be impaired, with a charge to the General Fund (IFRS 9) |
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| <p>Risk 4 The council is challenged in relation to the provision of state aid to CCHC (Category = Legislation, Reputation, Financial)</p> | |
| <p>Likelihood = Low Impact = High</p> | |
| <p>Cause</p> <ul style="list-style-type: none"> • Competitors become aware that the council is supporting CCHC financially and consider it to be anti-competitive • The existence of new competitors in the local marketplace implies that the SGEI exemption is no longer valid (Services of general economic interest (SGEI) are economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied (or would be supplied under different conditions) if there were no public intervention • The interest rate charged does not represent a market rate as | <p>Consequence</p> <ul style="list-style-type: none"> • Legal challenge • Costs to defend • Costs of compensation or other sanctions • Reputational damage • Officer time to manage |

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| <p>defined by the state aid regulations – either the EU base rate increases or the rate charged on the loan decreases.</p> <ul style="list-style-type: none"> • The council provides a subsidy by providing services to CCHC at less than cost | |
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| <p>Risk 5 CCHC becomes insolvent (Category = Financial, Reputation)</p> | |
| <p>Likelihood = Low Impact = Very High</p> | |
| <p>Cause</p> <ul style="list-style-type: none"> • Either Risk 1 or Risk 3 crystallise and the council decides it can no longer support the company • The external auditors question value for money in relation to support for the company • The council can no longer provide loans from its own cash resources | <p>Consequence</p> <ul style="list-style-type: none"> • Forced sale of property assets, may not enable council loans to be full repaid • Negative impact on General Fund • Reputational damage • Sanctions on council officers acting as CCHC directors |

4.2 A significant mitigation for the risks set out above would be to fix the financing costs for the company by refinancing the current £7.5m loan at a fixed rate that is sustainable for the company for a further three years. There are two considerations arising from this course of action. Firstly, there would be a risk that the loan could be challenged under State Aid regulations, and secondly that additional revenue above that receivable on a cash deposit would not be achieved.

4.3 The proposed approach prioritises the provision of affordable rented housing over financial return to the council for the duration of the loan. It will also allow the company to hold on to its property portfolio and build expertise and knowledge over the period that will stand it in good stead when business conditions improve.

- 4.4 State Aid rules indicate that, at present, the rate should be at least 2.00%, based on a reference rate of 1.00% and a margin of 100 basis points. Therefore renewing the loan at the existing rate of 2.02% would be possible.
- 4.5 However, it should be noted that:
- Interest rates are expected to rise over the next three years, with the reference rate rising in line with bank base rates, therefore this rate is likely to fall below the rate required by State Aid rules during the period of the loan.
 - The margin earned by the Council, above normal cash deposits rates, was about 1% when the initial loan was advanced. Due to increasing market interest rates this margin is currently about 0.6%, and it is likely to fall further during the three year period proposed.
- 4.6 In addition to considering the interest rate provided to CCHC, State Aid risk is also mitigated by the nature of the company's business – housing at affordable rents is not generally provided within a competitive market place. Whilst there are registered providers operating in Cambridge offering a similar product to CCHC, it is considered that the risk of challenge is very low, due to the low number of housing units owned by CCHC, and therefore the limited affect that the company has on the local market for affordable rented housing.
- 4.7 The directors' review notes that the council's S151 officer is one of the two company directors. However, in accordance with legislation, the directors must act in the best interests of the company, even if this is contrary to the council's wishes as shareholder. As the company is currently dependent on the continuing financial support of the council, this creates a conflict of interest for the S151 officer, even though she has a dispensation to act in the interests of the council, as shareholder, if required. The review therefore recommends that another director is appointed to strengthen the board.

5. Future development of the company

- 5.1 As the 100% shareholder of the company, the council will continue to explore how the company can be funded and developed to meet its dual objectives within acceptable levels of risk.

6. Implications

(a) Financial Implications

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As set out in the report.

(b) Staffing Implications

Housing management services are supplied to the company by the council's Town Hall Lettings team. Council staff provide administrative support, charged to the company at cost.

(c) Equality and Poverty Implications

No Equality impact Assessment has been done as this is a continuation of an existing service.

(d) Environmental Implications

None.

(e) Procurement Implications

The company procures services in line with the council's procurement regulations.

(f) Community Safety Implications

None.

7. Consultation and communication considerations

None, as this report recommends actions that will ensure the continuation of the services provided by Cambridge City Housing Company.

8. Background papers

Background papers used in the preparation of this report:

(a) Cambridge City Housing Company Draft Business Plan 2018/19 to 2027/28

9. Appendices

(a) Appendix 1 – Cambridge City Housing Company Internal Review – September 2018 considered exempt from publication under paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

10. Inspection of papers

To inspect the background papers or if you have a query on the report please contact Caroline Ryba, Head of Finance, tel: 01223 - 458134, email: caroline.ryba@cambridge.gov.uk.